INVASION OF THE INSURANCE FIELD BY THE STATE

ADDRESS
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Just now there is a considerable inclination in public opinion towards State Insurance of compensation for industrial injuries, owing to dissatisfaction with the casualty insurance companies on account of their high rates (actual or proposed) in the States which have recently enacted elective compensation laws. In public discussions of the workings of our old employers' liability laws it used to be common to hear all classes affected denounced as scoundrels and robbers—the employers and judges by employees, the workmen and juries by employers, and the lawyers and insurance companies by everybody. Then along came the advocates of "compensation" and pointed out that the fault was not with people, but with the law. Now, under a hybrid mixture of the compensation and the tort liability, it is expected that everybody will be good and everything generally satisfactory—that the workmen and employers may select whichever of two or three liabilities they want, and that for a trifling amount, insurance companies will assume the employers' risks and pay the bills. But the "wicked" insurance people, without experience under this new combination of liabilities, insist upon charging a rate calculated to cover the risk—which rate is high beyond popular expectations. Perhaps later some limited form of insurance under these conditions can be worked out, for which a more acceptable rate can be made. But in the meantime the companies are in for a torrent of abuse. And what is the remedy now being proposed? To amend the legal liability so as to make it more insurable? No. To build up employers' mutual insurance so as to furnish reasonable rates if the companies' rates are unreasonable? Again, no. But it is proposed to resort blindly to State Insurance. State Insurance has the advantage that it can offer most acceptable rates of premiums, for it need not make those rates high enough to pay for the risks—any deficiency caused by the rates being put below cost can be left for the taxpayers to settle later. And the "wasteful" expenses of private insurance can thereby be eliminated; for the expenses of investigating to fix rates can be avoided by simply guessing at them, and the expenses of investigating claims in

order to determine their validity can be avoided by simply allowing them. Having thus naively sidestepped all the disturbing difficulties in the way of administering the law rightly and of making ends meet, the problem becomes supremely simple and State insurance the ideal solution. But, if the problem of insuring compensation for industrial accidents cheaply can be thus simply solved, why not have the State insure everything for everybody in the same way regardless of cost and at "acceptable" rates—not only insure against industrial accidents but also against all accidents, sickness, death, old age, unemployment, insanity, fire, flood, etc.?

The answer to that question is, of course, obvious—that State insurance does not really solve the problem, but evades it.

In what follows I will present to you what, in my opinion, are the principal objections to State insurance of compensation.

In Europe and the Colonies of Great Britain there are four principal forms of the law of compensation for occupational injuries.

(1) The simple form of employers' direct liability for compensation—the form of Great Britain and its Colonies.

(2) Compulsory mutual insurance of compensation—the German and Austrian form.

(3) Compulsory State insurance of compensation—the monopolistic or Norwegian form.

(4) Compulsory insurance of compensation in various optional ways—the form of Italy, The Netherlands, etc.

Even if we believe—what is constantly appearing more doubtful—that the German system of compulsory mutual insurance is the best, yet we cannot adopt it, because it is fitted only to political, social and industrial conditions far different from ours. More particularly the trade associations, with power of regulation, etc., over the establishments of their members, are vital to the success of the German system. Without that feature the German system would result in the subsidization of careless employers at the expense of the careful—in short in the promotion of accidents.

As between the Norwegian system of monopolistic State insurance on the one hand, and the Italian and Dutch systems of competitive State insurance on the other hand, the tendency of opinion just now seems to be in favor of the Norwegian method. For if the State goes into the insurance business at all, it is simpler and cheaper for it to have a monopoly. Otherwise it will get the bad

risks and the risks in those employments for which it may accidentally place its rates too low, and will then have to compete with private companies for the good business, and, of course, incur a higher average cost of administration. The reason why the State cannot successfully compete with private companies is not far to seek; it is because it cannot conduct business as efficiently as can private enterprise. Its errors in rates are constant and flagrant. Its cost of administration is in some cases very low; but that is effected largely by omitting the expensive procedure requisite for right conduct and efficiency, so that the real cost to employers and to the public may eventually be very high. The State insurance office may secure the entire field to itself by operating at a loss; but if, to avoid that, it jacks up rates arbitrarily, private companies will underbid for the really good risks, and leave the State to carry the bad. We seldom hear well-informed advocates of State insurance boast of its success in Italy or the Netherlands. To thrive, State insurance must have a practical monopoly of the field in which it operates. Therefore, Norway is the model to follow, if we elect State insurance as our principal recourse.

The choice, therefore, narrows down until it lies between compulsory State insurance, as in Norway, and a simple compensation liability law, as in England—with provisions for compulsory security or insurance added, if deemed desirable.

There is one vital factor omitted in the calculations of the majority of the advocates of State insurance. Their object is merely to distribute the wage losses from industrial accidents. But that is not the sole object of a compensation law. Two of its principal objects are to do prompt average justice and to *prevent accidents.* These latter objects our advocates of State insurance generally ignore. It is the prevailing opinion of experts in industrial safety, that the imposition upon employers individually of the compensation liability for the accidents occurring in their respective establishments, is the most efficient single means of effecting a reduction in industrial accidents, and, therefore, that if the employer be required by law to insure the payment of that liability, the cost of his insurance should be very closely in proportion to what would be his direct liability were it not for the insurance. But if insurance enables an employer to shift the excess of his liabilities (over the average) upon his competitors, *the effect will be to encourage him to continue the use of dangerous processes, practices and equipment, obsolete machinery and cheap and unskilled labor, to increase the intensity of his labor*

and to relax his care and efforts for safety. If, for example, A is in competition with X, Y and Z, and his buildings, ways, machinery, etc., by reason of particular defects, while otherwise entirely efficient, are comparatively dangerous, so as to cause twice as many accidents (in proportion to numbers employed) as the respective plants of X, Y and Z, which are safer, but yet no more efficient, what material inducement is there for A to spend large sums to re-equip his plant for the sole purpose of avoiding a financial liability which X, Y and Z, all his competitors, must share equally with him anyhow? The illustration is crude, but the economic truth that it illustrates is the crucial factor to be dealt with in accident prevention. It is a thesis of the advocates of compulsory insurance: "That the cost of caring for injured workmen and their families should be paid in such a manner as to enter into the price of the products or the services and be paid ultimately by the consumer." But that thesis is indefinite, in that it does not specify into the price of what particular products that cost should enter. Referring to the previous illustration—if the cost of compensating for the accidents in the establishment of A should be proportionately five times that cost in each of the establishments of X, Y and Z, respectively, should the consumers of the products of X, Y and Z pay part of that item in the cost of the products of A, and should the consumers of the products of A get them at a price which does not include that full item in their cost, because a larger proportion of it has been shifted over upon A's competitors? I think not; and therefore contend that the thesis in question should be amended to specify that the cost of compensating workmen injured in the production of a product should be added as an item in the price of that product, and should not be distributed among other like products or among consumers generally; otherwise we would be subsidizing uneconomic production. It is perhaps possible that the State may be able, by statutory regulations, to compel all employers in each industry to maintain something approaching a common level of safety, so that a "flat" rate for each industry would correctly distribute the compensation cost. But such a level of safety could only be low; for State regulations are inevitably either merely elementary or too general, inelastic and *inexpert* to effect the high level of safety that could be reached if safety were to be made an economic advantage to the individual employer. Accidents are not so much in proportion to violations of State regulations as they are in proportion to the risks inherent in the trade, to the

care and conduct of the employer, to the character of his equipment (including personnel) and to the intensity of his "drive." It is simply folly to believe that the State by formal regulations can control these latter factors of danger as well as the employer can or as he would if given a direct pecuniary motive for so doing. And the idea that State officials, in fixing premium rates for State insurance, will gauge the differences between the levels of risks in different industries, so as correctly to distribute the accident cost between the different industries, has so far proved wholly imaginary in practice. Equally imaginary is the idea, embodied in the Washington law, that State officials can correctly differentiate as to exceptionally dangerous establishments in particular industries, for the purpose of imposing an exceptionally high premium rate upon such establishments—for that supposes a common level of safety, with a few conspicuous exceptions, whereas in fact, the different establishments in each industry are more apt to run the gamut from the highest to the lowest level in the scale of safety conditions, so that if the rate of insurance is varied for one it should, in fairness, be varied for many or for all. The German method of insurance in trade associations secures a proper distribution of accident cost as between the different trades; and, by confiding to each trade association powers of self-regulation, it generally succeeds in producing correct differentiation in rates, and thereby tends to reduce accidents. But the German method of insurance is not State insurance. And the German regulations for safety are principally corporate self-regulations and not State regulations. And no form of State insurance has ever yet been devised or suggested which fits this problem of promoting safety. The first objection to State insurance, therefore, is that it would result generally in an arbitrary flat rate in each trade, which while it might distribute the cost of compensating for accidents, would not distribute it *justly* nor so as to offer a pecuniary inducement to the individual employer to exert the utmost thought and care and to go to the extreme of his ability in expense in order to reduce the proportion of accidents in his own establishment. This objection to State insurance is illustrated by a comparison between the premium rates in England, under simple compensation, and the rates in Norway under State insurance. In England, the rate for each trade, being subject to competition, is elastic, and varies approximately in proportion to the estimated risk in each establishment. In Norway the rate for each industry is "flat"; and experience

shows that in the past the rates for the respective industries have generally been either about double, or about one-half the estimated cost of the compensation liability accrued; in other words, not only have the safer establishments paid part of the losses in the less safe establishments in the same trade, but many trades have paid part of the losses in other trades. Perhaps the rates may be adjusted until in time they will become approximately fair as between the different trades, although experience in Holland shows that even that is extremely improbable; but the vital objection will still remain that the careful employer will be made to pay the same rate as the careless employer—in short, that in regard to this whole subject employers will be reduced to the condition of mere wards of the State, so that each will have to take whatever rate the State may give him and will feel called upon to take only the precautions against accidents that the State may require. That is far from being the most effective way to prevent accidents. But it is a most effective first step on the way to *complete State control and operation of industries.*

We come now to the question of comparative cost. Under simple compensation, cost has only one aspect—namely, cost to the employer; although it is also material to study further how much of that cost may be economic waste in commissions and profits of the insurers; for the simple compensation liability leads to voluntary insurance in private companies only comparatively less general than compulsory insurance. Under compulsory State insurance there are two aspects in which to study cost, i. e., cost to employers and cost to the State. Care must therefore be exercised in comparing the premium rates under simple compensation and under State insurance, otherwise it will be a comparison between the whole cost and only a part of the cost—*for one of the great dangers of State insurance is that in the long run the premium rates charged employers will be a mighty small part of the cost to the State.*

There is only one working example of compulsory State insurance of compensation—the Norwegian system. Except as to justice and the prevention of accidents, which that system ignores—in other words, as a pure insurance proposition—the experience under the Norwegian system has so far been quite favorable, (i. e., so far as known, for Norwegian experience is to a large degree hidden from us by difficulties of language). To what extent that favorable experience has been due to the extremely favorable conditions

in Norway, is a question. The experiment has been on a small scale, for the population of Norway is only about 2,200,000, of whom only a relatively small proportion are engaged in industries covered by insurance; the population is stable, which is an important factor in cheapness and correctness of administration, and the vital dangers of the scheme have not yet been fairly tested, because it had been only a few years in operation and so far has happened to be under the charge of unusually competent insurance experts, and singularly free from politics. But even under such conditions, the insurance rates in Norway are not apparently any lower than medium English rates. It may be that the maximum English rates really prevail, in which case insurance in Norway is substantially the cheaper for employers; but it must be borne in mind that Norwegian insurance covers only compensation for accidents, while the English rates cover also a liability for compensation for occupational diseases and an alternative liability for full damages in tort in certain exceptional cases. And against any advantage in the Norwegian rates must be offset the fact that those rates have resulted in a deficiency in the reserves to cover accrued liabilities. It is true that the deficiency was small—only about $400,000—but on the same scale in New York or Pennsylvania a similar error would have resulted in a deficiency of some millions of dollars—no mere trifle to be made up by the public. And this misadventure under the careful Norwegian management indicates a grave danger of State insurance—namely, a tendency to make a good showing for cheap management, leaving it to the taxpayers generally to make good the loss from any probable error. The Washington scheme is a novel experiment on a small scale, but it is subject to even more dangers than the Norwegian scheme. The Ohio scheme has no requirements for any form of reserves and it has the functions of assessing premium rates and of adjudicating claims confided without rule or limitation to the discretion of a political board of three members, subject to political influences in the direction of low rates and high awards. It, therefore, is subject to vastly greater danger of miscarriage than the Norwegian scheme. Experience and reason both excite the fear that such schemes will result in deficiencies and occasionally in heavy deficiencies. And deficiencies would undoubtedly be most serious evils; for the effect of a deficiency is to transfer the burden of paying compensation from the employers responsible for the injuries, to persons not in any way responsible.

It is a strong argument in favor of State compulsory insurance that the expense of operation in Norway has been calculated to be only 11 per cent, while the corresponding expense of the English companies, under a regime of private compensation, had been about 36 per cent of premiums—in other words, what is generally regarded as an economic waste appears to be three times as great in England as in Norway. But the correctness of the 11 per cent figures is open to serious doubt, and the force of this argument is further weakened by two considerations: (1) So far as expense of operation covers the cost of investigation, etc., requisite for the differentiation of rates in proportion to the actual risks in each trade and under different employers and in different establishments it is not waste, *but is most desirable even at a high price.* Consequently, so far as State insurance saves expense by ignoring that differentiation where it is material, State insurance is "cheap" only in a derogatory sense—i. e., *it is bad.* (2) In Norway, under State insurance, all payments for compensation (except by several railroads, which are exempted from the law) are subject to this 11 per cent waste. But in England a material proportion of establishments, which pay their compensation obligations regularly, do not insure, or insure themselves and thus escape this waste altogether. And not only that, but under the latitude which the compensation law of England most wisely allows and encourages, but which a compulsory State insurance law would tend to discourage, some large establishments have evolved insurance and compensation schemes of their own—with and without reinsurance—more beneficial to employees and more effective for the prevention of accidents than any general scheme prescribed by any law. That is the ideal for large establishments—more desirable even than the German system at its possible best.*

Now, let us consider the specific dangers of State insurance. State insurance means that the State is to embark in business. The general object of business is to make a profit. But State insurance of compensation is not intended to make a profit. What, then, is its object? If there is general agreement upon its ob-

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*The principal explanation of the relatively low ratio of administration expense under the Norwegian law was overlooked in this address—which is that the Norwegian insurance is unconcerned with injuries lasting less than four weeks while the English insurance covers all injuries lasting over one week.

ject or upon several consistent objects, and little danger of its being diverted to other purposes—all right. But if, on the other hand, the advocates of compulsory State insurance have different and practically inconsistent objects, or if the scheme is subject to excessive danger of being diverted to other and less desirable purposes than those intended—all wrong. Now, as a matter of fact, the objects of compulsory State insurance are not clearly defined nor agreed to and it is peculiarly liable to be diverted from its original purposes. The Washington law is designed to prevent destitution by insuring to the victims of industrial accidents, not "compensation," but merely a minimum means of existence not proportioned to wage loss. The purpose is commendable; but it is not the object of the advocates of compulsory insurance of "compensation." And as a substitute for the liability for damages in all cases it is most improbable that the pittances which the Washington law allows will long content the working people—in other words, that law is almost certainly doomed to prompt amendments, that will change its purpose. The object of the Norwegian law is to insure compensation of the employees injured in each trade covered, at the expense of the employers in that trade, to be assessed ratably according to pay rolls; while the object of the advocates of a simple compensation law, with or without a legal obligation to insure added, is to secure compensation for industrial injuries at the expense of the particular employers responsible. These two objects are practically inconsistent. The most generally avowed object of the American advocates of compulsory insurance is to "distribute" the shock of the cost to employers of compensating for industrial accidents. But distribute among whom? Among the public generally, among all taxpayers, among those in nowise responsible? That is certainly the object towards which their schemes are directed, whether or not that be their conscious purpose. But to so distribute the compensation cost would in effect subsidize unnecessary extra-hazardous processes, methods and practices. That object, therefore, deserves the most emphatic condemnation. It is in effect an entirely different proposition from the economic doctrine that the accident cost in production should be distributed among consumers by adding that item in the cost of a product to its price—for that does not mean that the compensation cost in one product should be distributed among other products, but that it should be added to the price of *that particular product, if possible.* Equally objectionable is the purpose of State

insurance, which many of the representatives of the working people have in view. They claim that industrial employees are as much the benefactors of the State as soldiers, and deserve to be pensioned by the State for injuries, like soldiers, regardless of expense and of the methods of meeting that expense. But soldiers serve the State while private workmen serve their employers; and for the same reason that the State pensions the disabled soldier, the private employer—not the State nor the public—should compensate the disabled workman. State insurance, then, is not yet a formulated scheme with a definite object; but its advocates are divided into groups with diverse and inconsistent objects; and its social, industrial and economic effects will vary radically according to the objects towards which its methods, when formulated and defined, are directed. It may be used to throw a part of the accident cost of this generation over upon the succeeding generation, to subsidize the hazardous industries at the expense of the State or of the safer industries, to favor unionized trades at the expense of the non-unionized, or vice versa, etc., in short it is a screen behind which the cost of compensating for injuries may be shifted in any way and in any proportion that the legislature or the board of officials to whom the legislature confides the administration may make up its mind to, from time to time. In Ohio, for example, no methods of insurance are prescribed by law.* The Board of Awards may tax the employers affected almost as it chooses, may maintain the fund about as it chooses, and may make awards against the fund almost to whom it chooses and upon such evidence as it chooses—without right of appeal in anyone except the claimant. The scheme, therefore, is unformulated, indefinite and easily divertible towards any object that the Board of Awards, in the use or misuse of its discretion, may decide. And right there arises the political danger. There will be no direct private interest to keep individual claims within proper bounds, but there will be thousands of claimants exerting strong political pressure upon the board to allow exaggerated or illegal claims. Will the board stand firm, scrutinize all claims critically and incur the heavy expense requisite to investigate them properly? And will it court unpopularity with employers by imposing insurance rates high enough to establish safe reserves to meet the yearly accumulations of con-

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*This statement requires some qualification since the Ohio amendments of 1913.

tinuing pensions? Is it not more probable that it will commit the common error of omitting needful investigations in order to show a low rate of expense, allow exaggerated and doubtful claims in order to please the working people and fix low rates in order to please the employers? And if that probability occur, the scheme will become a social evil of the worst kind.

The problems involved in the adjudication or allowance of claims for compensation are serious enough to deserve separate consideration. Claims for compensation can not be indiscriminately allowed; for the tendency to malinger and the opportunities for fraudulent impositions in claims for dependency upon a compensation law are so great as to imperil the success of the whole scheme, unless effectively checked. The German practice of shifting the burden of compensation for the first thirteen weeks of disability onto the sickness insurance fund (to which the working people contribute about two-thirds) tends to check malingering; and the German employers' associations, which, in first instance, pass upon all claims, are diligent to prevent impositions; *nevertheless fraudulent impositions have been so great under the German scheme, as, in the opinion of many close observers, to condemn the whole scheme.* And in every State insurance country of which I have any information on this point—unfortunately, I have none as to Norway—the complaints about malingering and impositions are yet more insistent. And the difficulties of avoiding these abuses would be far greater here than in Europe. For in the Northern countries of continental Europe all points of information about a workman requisite to avoid impositions in the application of the compensation law in case of an injury to him are generally of record and easily accessible—his age, the fact of his marriage, the names and ages of his wife, children, parents, etc., are all facts easily ascertainable and proved. In America, on the other hand, with our lack of vital statistics and unstable and immigrant working population, such necessary facts are infinitely more difficult and expensive to ascertain and often impossible to prove. The opportunities for fraudulent claims for dependency, etc., are, consequently, far greater here than in Europe. *And in order to prevent malingering and exaggerations of disability upon a wholesale scale it will be essential to provide adequate and efficient machinery for a careful and critical investigation of all claims for disability.* On the Continent of Europe the machinery for that purpose existed ready made, at the time of the adoption of insurance laws, in the local

police and health officers, who, in highly centralized systems of government, are so closely correlated with central administration that they can be used most efficiently by the State insurance office for its purposes. But in American there is no such machinery. Are we then going ahead blindly with a scheme that foreign experience indicates is peculiarly apt to create a class of parasites upon employers' or State liability and a regime of fraud and imposture? This question does not apply to simple compensation, for there the employer is directly liable, and being "Johnny on the spot" will, with the means provided by the compensation law, protect himself against fraud and imposture; and, if he insure, his insurers will to some degree command his services, and besides, being in business for profit, will have an economic interest to go to the expense, miscalled economic waste, necessary to guard against imposition. *But where under compulsory State insurance, the State assumes the liability, the employer is out of it and the whole task of investigating claims will fall upon the State.* In New York, for example, there would pour into the State insurance office about 4,000 notices of accidents a month. How would the State deal with them? It should in each case ascertain whether the injury was one entitling the injured person to compensation, i. e., whether it arose out of and in course of the employment, and not from an excepted cause, etc. It should then ascertain the earnings of the injured workman, the nature of his injury and the degree and duration of his disablement—or, in case of fatal injury, the names, ages, residences, relationship, etc., of his dependents. Then, where pensions are allowed, it should continuously observe the pensioners so as to stop or reduce payments upon proper contingencies. And it is a *sine qua non* of the success of a compensation law that all these things should be done justly, according to the law, without partiality, with the lowest practicable margin of error and at minimum expense—for the expenses will be very material. The means provided for performing these functions in Ohio and in Washington seem to me ridiculously inadequate. The idea relied upon that a few officials in a central office—with the aid of a few investigators in the field to look into special cases or of district physicians serving part time for fees—can effectually sift out frauds and exaggerations in such a mass of claims, shows that the magnitude of the problem has been wholly unappreciated. Of course a small force can handle the initial adjudication of claims by making all claimants prove their cases by documentary evidence, as in Wash-

ington; but that imposes an unendurable hardship upon the working-people, and misses the great advantage of a simple compensation law, as exemplified in England—which is that it results generally in the prompt payment of compensation without intermediate formalities.

Turning from the difficulties of doing what ought to be done under State insurance to the facilities that it offers for doing what ought not to be done, we naturally look to that exemplar of all imperfections—the Ohio law. We find there provisions for a board of three political functionaries, clothed with the power to award judgments for compensation against the insurance fund to alleged victims or alleged dependents of alleged victims of industrial accidents. From a judgment by that board—if entirely adverse—a claimant may appeal; but neither the State nor a taxpayer. Here then is a single board which is expected to adjudicate conclusively against the insurance fund upon hundreds of claims a month. For every claim rightly rejected or reduced a political enemy will be created; while for false or exaggerated claims allowed there will be no one personally and directly interested to object. It is then a not improbable prediction that the board will in time bend in the direction of allowing all claims—particularly as that would avoid the cost of investigation and thereby keep down the expense of administration, which expense it is now the fashion to regard altogether as economic waste. And if that board should bend from the strict line of duty, it is more than probable that it will bend far and avail itself to the full of its political opportunities, which are to distribute judgments for pensions according to political influences. If such misuse of its power by the board should be accompanied, as it naturally would be, by a prompt and sympathetic allowance of all just and meritorious claims, the support of the only class directly interested in the distribution of the insurance fund, i. e., the working-people—would probably be secured; and it is difficult to see what political check would act to stop the easy misuse of this scheme, until the exhaustion of the fund or the creation of a startling deficiency should arouse the general public.

MY CONCLUSION, THEN, IS THAT IN EXPERIMENTING WITH STATE MANAGED INSURANCE WE ARE PLAYING WITH FIRE; THAT THE COURSE OF SUCH INSURANCE IS UNCHARTED AND RUNS PERILOUSLY CLOSE BETWEEN THE SCYLLA OF SOCIALISM AND THE CHARYBDIS OF ORGANIZED GRAFT.